
ANATOMY OF A CORPORATE COLLAPSE: THE DOWNFALL OF DEWAN HOUSING FINANCE CORPORATION LTD

Vidisha Pagaria, OP Jindal Global University

ABSTRACT

The DHFL scam stands as a significant example of the catastrophic failures within the Indian financial system, particularly in the governance and oversight of Non-Banking Financial Companies (NBFCs). Dewan Housing Finance Corporation Ltd. (DHFL), a key player in mortgage financing, primarily serving middle- and lower-income families, became emblematic of these failures. The exposure of DHFL's fraudulent activities, amounting to over Rs. 30,000 crores, underscores the severe deficiencies in corporate governance and the inability of existing regulatory frameworks to prevent such systemic risks.

This research delves into the DHFL scandal, illustrating how a combination of poor governance, insufficient compliance with Environmental, Social, and Governance (ESG) standards, and the incompetence of financial analysts culminated in one of the most significant financial frauds in India's history. The analysis also highlights the startling fact that while a relatively obscure news outlet could uncover this extensive fraud by simply reviewing publicly available documents, the responsible authorities and more prominent financial institutions failed to detect or prevent the wrongdoing.

The fraudulent practices at DHFL, particularly the disbursement of unsecured loans to shell companies, exacerbated the twin balance sheet problem in India, contributing to the burgeoning issue of non-performing assets and further eroding public trust in the financial sector. The paper argues for a comprehensive overhaul of the regulatory framework governing NBFCs, as evidenced by the Reserve Bank of India's proposed four-tier structure, to mitigate such risks in the future. The DHFL scam not only highlights the urgent need for stricter regulatory oversight but also serves as a cautionary tale about the broader implications of governance failures in financial institutions.

INTRODUCTION

Dewan Housing Finance Corporation Ltd., presently known as Piramal Capital & Housing Finance Limited, is a fully owned subsidiary of Piramal Enterprises Limited (the flagship company of Piramal Group). It is a non-banking financial institution that was founded in 1984 by Rajesh Kumar Wadhawan. The organisation was established to provide access to housing finance for people in India's tier 2 and tier 3 cities who fall between the lower and moderate-income brackets.¹

In essence, it is a shadow bank. This term refers to the practice of non-bank financial institutions engaging in banking-like operations without being subject to the same level of oversight as traditional banks. However, these organisations play a crucial role in the financial system by acting as go-betweens for investors and borrowers, so facilitating the creation of credit and market liquidity. In other words, it provides financial services while not being a bank and without having access to central bank liquidity.²

BACKGROUND OF THE CASE

In 2018, IL&FS, an investment and financing firm, collapsed. It failed to meet its financial obligations, including the redemption of commercial paper (CP) and repayment of bank loans.³

The NBFC industry, which provides shadow banking services in the country, was rattled by this development. This caused a severe liquidity crisis that hit all NBFCs severely. Dewan Housing Finance Corporation was one of them. Due to the higher entropy of risk, DHFL's shares dropped as much as 60% in September 2018.⁴

COBRAPOST EXPOSÉ

On January 29, 2019, a group of journalists called Cobrapost released an exposé on DHFL. The promoters of the Dewan Housing Finance Corporation were accused of embezzling more

¹ Piramal Finance, <https://www.piramalfinance.com/about-us/company>

² Laura E. Kodres, Shadow Banks: Out of the Eyes of Regulators, International Monetary Fund <https://www.imf.org/external/pubs/ft/fandd/basics/52-shadow-banking.htm>

³ What is IL&FS crisis, Business Standard, <https://www.business-standard.com/about/what-is-il-fs-crisis>

⁴ NBFC's crash – why DHFL tanked over 60 in trade today, Business Standard https://www.business-standard.com/article/markets/nbfc-crash-here-s-why-dhfl-tanked-over-60-in-trade-today-118092100479_1.html

than Rs 31,000 crore from the government between 2015 and 2018, according to these allegations.

In order to carry off their elaborate scheme, DHFL's principal stakeholders Kapil Wadhawan, Aruna Wadhawan, and Dheeraj Wadhawan used proxies and allies to have massive sums of money loaned to questionable shell/pass-through firms, which then funnelled the funds to businesses owned by the Wadhawan family. The funds were utilised to acquire private equity and other assets in India and other countries.

DHFL has granted millions of crores to these shell companies under the pretence of secured loans against slum development projects without conducting the requisite due diligence, assessing collateral, or maintaining an adequate debt-equity ratio. Moreover, they were accused of Insider Trading, which is against SEBI regulations.

Additionally, they had also donated crores to political parties, presumably as a kind of protection. More specifically, they gave the Bharatiya Janata Party a total of Rs. 19.5 crores. There was also a lack of oversight on the part of the banks that had provided money to the business as well. As much as Rs 50 crores were lent to the firm by at least 32 different Indian banks.

DHFL was not only accused of breaking many rules outlined in the Companies Act, the Income Tax Act, and the Foreign Exchange Management Act but also for breaking regulations set forth by the Reserve Bank of India, the Security and Exchanges Board of India, the Union Ministry of Finance, the Income Tax Department, and the monitoring systems of the banks.⁵

AFTERMATH

The company first refuted these charges, and Indian credit rating organizations confirmed their previous high safety rating for DHFL. But the company's behaviour contradicted their words. So as to meet their mounting financial obligations, they started selling off various enterprises. The final nail in the coffin was on June 4th, 2019, when DHFL missed payments totalling 900cr. Crisil, a credit rating agency downgraded DHFL's commercial paper (CP)

⁵ Aniruddha Bahal, DEWAN HOUSING FINANCE CORPORATION LIMITED- THE ANATOMY OF INDIA'S BIGGEST FINANCIAL SCAM, Cobrapost , JANUARY 29, 2019, <https://cobrapost.com/blog/biggest-financial-scam/1373>

from 'A4+' to 'D' because of its outstanding debts. This led to a 15% drop in the value of the share price.⁶

DHFL's defaults necessitated RBI intervention for processing a resolution for the company under the Insolvency and Bankruptcy Code. The RBI terminated the company's board of directors on November 20th, 2019, for failing to uphold proper corporate governance and for failing to meet its financial commitments.

The insolvency procedure for DHFL coincided with a wave of raids and investigations by government authorities looking into suspicions of money laundering and participation with criminal organisations. DHFL promoter Kapil Wadhawan was arrested for violating the PMLA because of his alleged role in providing loans to criminal groups. Yes Bank was also implicated by the ED in a series of fraudulent transactions involving debentures in DHFL totalling Rs 3,700 crores.

On January 2021, the committee of creditors (CoC) approved Piramal Group's offer to fully acquire DHFL for Rs 34,250 crores. Creditors of DHFL were able to recoup up to about 40% of their total acknowledged dues under the resolution plan.

ANALYSIS

The entire DHFL scam is a testament to the lack of adequate governance of the financial institutions. It's a failure of corporate governance and an indictment on the competence of analysts when even firms with A4+ standard ratings and stringent internal control systems like DHFL nevertheless fail to adhere to corporate ethics. This form of oversight in governance exemplifies the consequences of failing to meet ESG (environmental, social, and governance) requirements.

This instance highlights the callous neglect and failure of the involved authorities, as a relatively minor news station could unearth a Rs. 30,000 crores + fraud by reviewing and evaluating official documents of government authorities as well as data symmetrically

⁶ Shayan Ghosh, Crisil, Ica downgrade DHFL's commercial paper rating to default, Live mint, 05 June 2019 <https://www.livemint.com/companies/news/crisil-downgrades-dhfl-s-rs-850-crore-commercial-paper-rating-to-default-1559735033714.html>

available in the public domain whereas other individuals were not even ontologically cognizant of it.

Considering the fact that this entire scam was carried out mainly by sanctioning and paying out funds in unsecured and dubious loan amounts, a heuristic background check on the shell companies, its security or collateral before granting the loan could have reduced the 'unknown' factor (KuU framework) in the financial and corporate failure.

The systematic risk of money laundering and tax evasion adopted by DHFL systemically affected the economy of India. Since this exacerbates the twin-balance sheet problems of huge amounts of non-performing assets and severely debt-laden corporations, which is particularly problematic for the banking industry of a developing country like India. Additionally, it undermines people's faith in the banking system as a result of the higher entropy of risk associated while depositing money in financial institutions like banks and NBFCs.

There is a pressing need to realign the regulatory framework for NBFCs in light of their fluctuating positioning in the entropy of risk as the economy develops and an increasing number of organisations grow to become systemically vital. This event has just further elucidated the dire need for a stricter regulatory framework for NBFCs. This is mirrored in RBI's proposed four-tier structure, which would increase the regulatory governance of NBFCs substantially.